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No. 95-1233

# In the Supreme Court of the United States

OCTOBER TERM, 1995

COST CONTROL MARKETING & SALES MANAGEMENT OF VIRGINIA, INC., ET AL., PETITIONERS

*v.*

HENRY G. CISNEROS, SECRETARY OF HOUSING AND URBAN DEVELOPMENT

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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## QUESTIONS PRESENTED

1. Whether petitioner Cost Control Marketing and Sales Management of Virginia, Inc., which engaged in the interstate marketing and sale of land, is a "developer" within the meaning of the Interstate Land Sales Full Disclosure Act, 15 U.S.C. 1701(5).

2. Whether the disgorgement ordered by the district court, payable to the Secretary of Housing and Urban Development, is exempted from the discharge provisions of the Bankruptcy Code under 11 U.S.C. 523(a)(7), which exempts from discharge any "fine, penalty, or forfeiture" that is payable "to and for the benefit of a governmental unit," and is "not compensation for actual pecuniary loss."

3. Whether the district court properly ordered disgorgement to respondent based on evidence in affidavits presented by respondent that was not controverted by any petitioner.

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the court of appeals from which review is sought (Pet. App. A1-A15), affirming final judgment for respondent, is reported at 64 F.3d 920. The opinion and order of the district court directing the entry of final judgment (Pet. App. A62-A72) are reported at 862 F. Supp. 1531. The report of the magistrate judge recommending the entry of final judgment for respondent (Pet. App. A53-A61) is unreported.

A prior opinion of the court of appeals (Pet. App. A22-A30) is reported at 940 F.2d 110. The opinion and order of the district court directing an interim final judgment (Pet. App. A31-A50) are reported at 790 F. Supp. 1275. The order of the district court entering a preliminary injunction (Pet. App. A16-A21) is unreported.

## JURISDICTION

The judgment of the court of appeals was entered on September 8, 1995. A petition for rehearing was denied on November 3, 1995. Pet. App. A77-A78. The petition for a writ of certiorari was filed on January 31, 1996. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. Petitioner Cost Control Marketing and Sales Management of Virginia, Inc. (CCMV) is a Virginia corporation formed for the sole purpose of purchasing, marketing, and selling unimproved lots of land in Lake Monticello, Virginia, a subdivision of over 4,500 lots. Pet. App. A3, A23. CCMV is wholly owned by three of its officers, petitioners Peterson, Kujawski, and Marley. *Id.* at A3. Petitioner Costenbader is Chief Executive Officer of CCMV. *Ibid.*

Between 1986 and 1989, CCMV purchased over 900 unimproved lots in the Lake Monticello subdivision, and then marketed those lots to prospective purchasers in Washington, New York, and elsewhere. Pet. App. A3. By the end of 1989, CCMV had sold 585 lots. *Ibid.* None of CCMV's sales complied with the Interstate Land Sales Full Disclosure Act (ILSFDA or the Act), 15 U.S.C. 1701 *et seq.*, which, like the federal securities laws, imposes certain registration and disclosure requirements and prohibits fraudulent

and misleading sales practices. See generally *Flint Ridge Development Co.* v. *Scenic Rivers Ass'n*, 426 U.S. 776, 778 (1976); *Cost Control Mktg. & Management, Inc.* v. *Pierce*, 848 F.2d 47, 48 (3d Cir. 1988).

Under ILSFDA, developers and agents may not use any means of interstate commerce or the mails to offer or sell lots in a subdivision without registering the property by filing a statement of record with the Department of Housing and Urban Development (HUD). 15 U.S.C. 1703(a)(1)(A) and 1704.[1] Developers and their agents also must furnish a prospective purchaser with a complete and accurate printed disclosure statement, known as a "property report," prior to the execution of any sales contract. 15 U.S.C. 1703(a)(1)(B) and 1707. Purchasers may revoke their contracts within two years if they were not provided property reports prior to signing the contracts. 15 U.S.C. 1703(c). The Act prohibits misleading sales practices and mandates certain sales practices to inform and protect consumers. 15 U.S.C. 1703(a)(2). The Act also makes it unlawful for any developer or agent to "obtain money or property by means of any untrue statement of a material fact, or any omission to state a material fact." 15 U.S.C. 1703(a)(2)(B). Finally, the Act prohibits developers and agents from engaging "in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon a purchaser." 15 U.S.C. 1703(a)(2)(C).

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[1] The Act defines a "developer" as "any person who, directly or indirectly, sells or leases, or offers to sell or lease, or advertises for sale or lease any lots in a subdivision." 15 U.S.C. 1701(5). An "agent" is "any person who represents, or acts for or on behalf of, a developer in selling or leasing, or offering to sell or lease, any lot or lots in a subdivision." 15 U.S.C. 1701(6).

CCMV failed to register its lots, failed to provide required property reports to purchasers, failed to inform purchasers of their two-year right to rescind, and refused to rescind sales upon purchasers' requests. Pet. App. A4. CCMV also used high-pressure, misleading marketing techniques. *Ibid.* As a result of these unlawful practices, CCMV was able to sell lots at over three times their assessed value. *Ibid.*

2. On November 15, 1989, HUD filed suit against petitioners in district court, alleging that petitioners had violated the registration and disclosure provisions of ILSFDA, and had engaged in sales practices prohibited by the Act, including overcharging for closing costs, misleading advertising, and misinforming purchasers regarding their revocation rights. Pet. App. A4, A24. HUD requested injunctive relief and disgorgement of petitioners' illegal profits. *Id.* at A4, A93-A96. On February 14, 1990, the district court granted a preliminary injunction against future violations of the Act by petitioners and froze the individual petitioners' assets. *Id.* at A16-A21.

On interlocutory appeal, the court of appeals affirmed the preliminary injunction, but remanded the case to the district court for factual findings under Federal Rule of Civil Procedure 65(d) in connection with the asset freeze. Pet. App. A24. In affirming the issuance of the injunction, the court of appeals rejected petitioners' sole defense to liability, and held that CCMV could be held liable under the Act's definition of "developer" in Section 1701(5), and that the individual petitioners could be held liable as "agents" of CCMV under Section 1701(6). Pet. App. A4, A26-A27.

3. On April 22, 1992, after having granted summary judgment in favor of HUD on all counts, the district court issued an interim judgment order. Pet. App. A31-A50. The court concluded that petitioners' violations constituted "part of a pattern of conduct that suggests a strong propensity to repeat itself in the absence of a permanent injunction." *Id.* at A33. The court found that petitioners "appear to be absolutely unrepentant." *Ibid.* It noted that petitioners had been twice held in contempt by the magistrate judge for defying the court's orders, and had otherwise made it clear to the court that they did "not feel bound by the orders of this court (or by the law)." *Id.* at A33-A34. Accordingly, the court permanently enjoined petitioners from enforcing any obligation to pay in connection with their sale of lots at Lake Monticello. *Id.* at A47.

In its interim judgment order, the district court also considered HUD's request for disgorgement of petitioners' illegal profits, and found that HUD's proposed disgorgement figure of $8,648,048 was a "reasonable approximation" of the amount of profits petitioners received from their unlawful activities. Pet. App. A38, A43-A45. The court stated that, at the appropriate time after discovery, it would calculate the precise amount of profits that were causally connected to the violations and had been passed through CCMV to each individual petitioner. *Ibid.*

On September 1, 1992, three of the four individual petitioners in this case (Peterson, Marley, and Costenbader) filed individual bankruptcy petitions under Chapter 7 of the Bankruptcy Code. Pet. App. A6. On September 4, 1992, pursuant to the interim judgment order, HUD served all four individual petitioners with discovery requests, seeking information

about the profits received from their illegal sales, their current assets and liabilities, and transactions with their relatives. *Id.* at A6-A7. None of the petitioners responded to HUD's interrogatories. *Id.* at A7-A9. Moreover, none of the petitioners submitted any evidence to the court challenging HUD's proposed disgorgement relief of $8,648,048, or demonstrating that they should not each incur continuing joint and several liability for that entire amount. *Ibid.*

4. On September 15, 1994, the district court entered final judgment against petitioners. Pet. App. A62-A72. The court rejected petitioners' contention that their bankruptcy petitions prevented HUD's enforcement action from going forward. It held that, because this action was brought by HUD to enforce its regulatory powers, it is exempt from the automatic stay provisions of the Bankruptcy Code pursuant to 11 U.S.C. 362(b)(4). It also held that the disgorgement relief in this case is excepted from the Bankruptcy Code's discharge of debts under 11 U.S.C. 523(a)(7), as a "fine, penalty, or forfeiture" payable "to and for the benefit of a governmental unit" that is "not compensation for actual pecuniary loss." Pet. App. A64-A68. The district court also noted that, after more than 27 months, petitioners had failed to rebut or even challenge HUD's figure of $8,648,048 as a reasonable approximation of the illegal profits that should be disgorged. Pet. App. A70. Accordingly, it entered judgment against petitioners in that amount, payable to the Secretary of HUD, and it permanently enjoined petitioners from violating the Act or enforcing any obligations against purchasers of Lake Monticello lots. *Id.* at A73-A76.

5. The court of appeals affirmed. Pet. App. A1-A15. It first held, as it had on the interlocutory appeal, that CCMV is a "developer" under Section 1701(5). Pet. App. A8. It then rejected petitioners' challenge to the sufficiency of HUD's proof in support of the disgorgement order, noting that HUD's evidence was "absolutely uncontradicted" by petitioners. *Id.* at A10. The court reasoned that the Declaration of Roger Henderson, Director of HUD's Interstate Land Sales Registration Division, upon which the district court's award was based in part, served "as a summary of voluminous evidence" and that "[s]omething like it would doubtless have been permitted at a trial of this case." *Ibid.* The court also noted that the Henderson Declaration was corroborated by other evidence of record, including the sworn declarations of 11 lot purchasers. It concluded that HUD had carried its burden of coming forward with a "reasonable approximation of the illegal profits." *Id.* at A10-A11 (citing *SEC* v. *First City Financial Corp.*, 890 F.2d 1215 (D.C. Cir. 1989)).

The court of appeals also agreed with the district court that the Bankruptcy Code does not shield petitioners from the district court's disgorgement order. Pet. App. A12-A14. It ruled that this enforcement action brought by HUD is exempted from the automatic stay provision of the Code by 11 U.S.C. 362(b)(4), which exempts "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power." See Pet. App. A12-A13. It also ruled that, under 11 U.S.C. 523(a)(7), the disgorgement award is excluded from the discharge of petitioners' debts as "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit,

and * * * not compensation for actual pecuniary loss." See Pet. App. A13-A14.

**ARGUMENT**

1. Petitioner CCMV contends (Pet. 7-14) that it was not a "developer" covered by ILSFDA, 15 U.S.C. 1701(5), because it was merely a seller of already developed property (Pet. 8). That contention is incorrect. The Act defines a "developer" as "any person who, directly or indirectly, sells or leases, or offers to sell or lease, or advertises for sale or lease any lots in a subdivision." 15 U.S.C. 1701(5). Although the Act may have been directed in large part at those who market undeveloped property, it is not limited to those sellers, and its definition of "developer" does not distinguish between original developers and subsequent large-scale resellers of developed "lots in a subdivision."

As the lower court observed in rejecting a similar argument in an earlier case, "[t]o exclude all but the original developer from the purview of the Act would clearly circumvent its intent by permitting developers to simply transfer land to separate entities before being sold to the public." *Olsen* v. *Lake Country, Inc.*, 955 F.2d 203, 205 (4th Cir. 1991), cert. denied, 503 U.S. 972 (1992). Moreover, in many situations, it may be unclear whether a subdivision has in fact been "developed"; in *Olsen*, for example, "there were serious questions concerning the ability of the water supply and sewer system to service all homes in the subdivision." *Id.* at 206. In addition, under HUD regulations implementing the Act (see 15 U.S.C. 1707), the "property report," or disclosure statement to prospective customers, required of developers must set forth important information that

does not turn on the developed status of the subdivision, including information about encumbrances, utility connections, and the financial situtation of the developer. See 24 C.F.R. 1710.100 *et seq.* Contrary to CCMV's contention (Pet. 8-9), therefore, it is not true that "the potential buyer does not need disclosure of the features of a completed development, for the subdivision in place speaks for itself." See also *Winter* v. *Hollingsworth Properties, Inc.*, 777 F.2d 1444, 1447 (11th Cir. 1985) (noting that ILSFDA is not limited to sales of "raw land" but is applicable "to *all* lots" in a subdivision).[2]

"The general purpose of [ILSFDA] was, of course, to prohibit and punish fraud in * * * land development enterprises * * * and the Act should be interpreted to attain that end. Such an act should be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *McCown* v. *Heidler*, 527 F.2d 204, 207 (10th Cir. 1975).[3]

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[2] ILSFDA does not cover sales of *improved* land on which an already completed residential building exists. See 15 U.S.C. 1702(a)(2). This case does not involve that exemption. Also, the registration and disclosure requirements of ILSFDA do not apply to the sale of lots in a subdivision containing fewer than 100 lots, 15 U.S.C. 1702(b)(1), and the Act as a whole does not apply to the sale of lots in a subdivision containing fewer than 25 lots (unless the method of disposition is designed for the purpose of evading the Act), 15 U.S.C. 1702(a)(1).

[3] Although petitioner suggests (Pet. 9) that *McCown* applied an "opposite interpretation" of the Act by considering extenuating facts and circumstances, that case did not involve the question whether ILSFDA applies to sellers of developed lots. *McCown* held that officers and directors of a corporate developer could be held liable under ILSFDA as controlling persons, or aiders and abettors, of the corporate developer. 527 F.2d at 207.

Given the clear language of the Act, its remedial purposes, and the difficulty of drawing a clear line between "developed" and "undeveloped" lots, there is no reason to conclude that Congress intended to exclude sellers of lots like CCMV from the reach of the Act.

The other appellate cases relied on by CCMV (Pet. 9-10) are not to the contrary. In *Bartholomew* v. *Northampton National Bank of Easton*, 584 F.2d 1288 (3d Cir. 1978), the court concluded that a bank that provided financing for a development project was not liable under ILSFDA as an "indirect seller" or aider and abettor of the primary developer. The court reached that conclusion, not because the lots at issue were already developed (they were not), but because the bank did not actively participate in the actual sales of the lots. *Id.* at 1292-1293; see also *Adema* v. *Great Northern Development Co.*, 374 F. Supp. 318 (N.D. Ga. 1973). In *Cumberland Capital Corp.* v. *Harris*, 621 F.2d 246 (6th Cir. 1980), the court held that a bank that occasionally sold lots on which it foreclosed as an outgrowth of its lending activities was not a developer. The court did not emphasize the developed or undeveloped status of the lots, and it noted that arguably the bank fell within the strict definition of "developer." *Id.* at 250. It emphasized, however, that the statutory definition of "subdivision" requires that the lots in a subdivision be sold pursuant to a "common promotional plan," *ibid.*, which was not true of the bank's "involvement in land sales, undertaken only as necessitated by defaulting borrowers, [and] truly 'incidental' in character," *id.* at 249.

2. Petitioners Costenbader, Peterson, and Marley argue (Pet. 14-22) that the Bankruptcy Code's dis-

charge provisions shield them from the district court's disgorgement order. In particular, they take issue with the lower courts' conclusions that the disgorgement order is exempt from discharge because it is "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss." 11 U.S.C. 523(a)(7).

Petitioners contend (Pet. 14-16) that "civil restitution orders" are not exempt from discharge under Section 523(a)(7). In *Kelly* v. *Robinson*, 479 U.S. 36 (1986), this Court held that restitution orders imposed in criminal prosecutions are excepted from discharge under Section 523(a)(7). The Court emphasized that that Section creates "a broad exception for all penal sanctions, whether they be denominated fines, penalties, or forfeitures." 479 U.S. at 51. The Court subsequently made clear that Section 523(a)(7) covers both civil and criminal fines, penalties, and forfeitures. See *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 495 U.S. 552, 561-562 (1990).

The disgorgement at issue in this case is sufficiently penal to be considered a "fine, penalty, or forfeiture," for purposes of Section 523(a)(7), even though it was entered in a civil proceeding.[4] HUD

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[4] Petitioners rely (Pet. 17) on part of the definition of "forfeiture" in *Black's Law Dictionary*. That entry, however, also defines "forfeiture" as the "[l]oss of some property or money because of breach of a legal obligation," without any distinction between the criminal and civil contexts. *Black's Law Dictionary* 650 (6th ed. 1990). The disgorgement order in the instant case is unquestionably a "forfeiture" in the common usage of that term, since the amount disgorged represents the profits on petitioners' land sales that petitioners have been

brought this action against petitioners under 15 U.S.C. 1714(a), which permits such actions when the Secretary believes that any person is engaged in "a violation" of the Act. See Pet. App. A83. And as the magistrate observed (*id.* at A57-A58), "pursuit of the judgment in this case has been driven by a desire to punish [petitioners] for their clear violations of the law and to serve as a deterrent [to violations] of the Act, not by a desire for victim compensation." See also *id.* at A68 (same observation by district court).[5]

The disgorgement order also satisfies the two additional requirements of Section 523(a)(7). The award is indisputably payable "to and for the benefit of a governmental unit," since the order requires that the $8.65 million judgment be paid directly to the Secretary of HUD and places no restrictions on its use by the Secretary. Pet. App. A68, A74. The award is also "not compensation for actual pecuniary loss." As the court of appeals pointed out (*id.* at A14), in the context of Section 523(a)(7), that phrase "refers to the *government's* pecuniary loss." There is no such loss implicated in this case.[6] Moreover, the purpose of the

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required to forfeit as a result of their breach of their legal obligations under the Act.

[5] Petitioners' argument (Pet. 20-21) that HUD should have resorted to the civil penalty provisions of ILSFDA is unavailing. Those provisions did not become effective until December 15, 1989, after the complaint in this action was filed, and their application was expressly prospective. 15 U.S.C. 1717a note.

[6] In *Kelly* v. *Robinson*, *supra*, the Court concluded that a restitution order is not "compensation for actual pecuniary loss" because "[t]he sentence following a criminal conviction necessarily considers the penal and rehabilitative interests of the State." 479 U.S. at 53. Although the Court therefore

disgorgement award is not compensatory, even as it relates to the private victims of petitioners' violations of the law. The purpose of the disgorgement is to ensure that petitioners do not profit from their illegal sales practices; thus, the award is based, not on what the victims lost, but on what petitioners illegally gained, as a result of their violations of the Act.

*In re Taite*, 76 B.R. 764 (Bankr. C.D. Cal. 1987), the sole case petitioners offer in support of their dischargeability argument (Pet. 20-21), is not to the contrary. The court in *Taite* expressly ordered that the relief awarded "shall be used to reimburse * * * customers for funds they paid to defendants or their assignees." 76 B.R. at 772. As a result, the *Taite* court found that the relief ordered in that case was of the type "primarily intended to compensate victims for their losses," and was, therefore, not exempt under Section 523(a)(7). *Ibid.* *Taite* is inapposite to the award in the instant case, which does not require compensation of petitioners' customers. Moreover, the award in this case was entered principally for the purposes of punishment and deterrence, not compensation of petitioners' customers, and was not based on the amount that those customers lost to petitioners.

3. Finally, petitioners challenge (Pet. 22-29) the sufficiency of the evidence supporting the district court's disgorgement order. That challenge is without merit.

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rejected the argument that the restitution order was intended "'for . . . compensation' of the victim," *ibid.*, it did not hold that Section 523(a)(7) refers to pecuniary loss by a private party, rather than the governmental unit to which the fine, penalty, or forfeiture is directly owed.

Because separating legal from illegal profits precisely can be "a near-impossible task," the courts have recognized that the actual calculation of disgorgement "need only be a reasonable approximation of profits causally connected to the violation." *SEC* v. *First City Financial Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989). In finding that HUD had satisfied its burden of coming forward with a "reasonable approximation" of petitioners' illegal profits, the district court relied in part upon the Declaration of Roger Henderson, Director of HUD's Interstate Land Sales Registration Division, which set forth an approximation of the profits that petitioners derived from their illegal land sales. See Pet. App. A10, A98-A100. The Henderson Declaration's disgorgement figure was based on the average disparity between petitioners' sales price and the fair market value of the lots—$18,558—multiplied by the 466 lots known at the time to have been sold in violation of the Act. *Id.* at A6. This calculation yielded gross illegal profits of $8.65 million, the amount to be disgorged. *Ibid.* Petitioners produced no evidence to call that calculation into question.

Petitioners contend that the Henderson Declaration is hearsay and was therefore inadmissible on summary judgment. As the court of appeals concluded, however, the Declaration serves as a summary of voluminous evidence, and something like it "would doubtless have been permitted at a trial of the case." Pet. App. A10 (citing Fed. R. Evid. 1006).[7] The

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[7] Although the Henderson Declaration concerned the remedy rather than petitioners' substantive liability, the court of appeals analyzed the evidentiary question under the standards applicable to summary judgment under Federal Rule of

Declaration established the average sales price through the results of a survey of lot purchasers, corroborated by sworn declarations of a sampling of 11 purchasers. Pet. App. A10-A11. The average fair market value was established by HUD through records of the tax-assessed values of the lots, which the court of appeals held admissible under Federal Rule of Evidence 803(6). *Id.* at A11 n.10.[8]

HUD's case could have been proven at trial through the testimony of state tax officials and the testimony of each of the 466 purchasers, but in light of petitioners' failure to contradict HUD's evidence, such a showing was not necessary. As the court of appeals observed, "the practical question" was "whether the case present[ed] a genuine issue of fact for trial rather than whether the parties have put their evidence in final form." Pet. App. A10 n.8. HUD came forward with a reasonable method, based upon reliable sources of information, to calculate petitioners' total profits; in 27 months, petitioners failed to come forward with any evidence to contradict that calcu-

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Civil Procedure 56. Rule 56(e) requires that supporting materials on summary judgment must set forth facts "as would be admissible" at trial. In *Celotex Corp.* v. *Catrett*, 477 U.S. 317 (1986), this Court noted that Rule 56(e) is satisfied by submissions capable of being "reduced to admissible evidence." *Id.* at 327. Federal Rule of Evidence 1006 permits the admission into evidence of "a chart, summary, or calculation" when the contents of "voluminous writings * * * cannot conveniently be examined in court." Therefore, the court of appeals' analysis under the summary judgment standard was correct.

[8] Virginia law requires the tax assessments of real estate to be made at 100% of the fair market value. Va. Ann. Code § 58.1-3201 (Michie 1991). The district court found that the county assessments "establish[ed] with a high degree of certainty the fair market value of the properties." Pet. App. A38.

lation. See *id.* at A12 (noting that petitioner's evidence "is nil").

As for establishing the specific amount of funds that went to each individual petitioner, the district court held that "facts before the Court create a strong presumption that a substantial portion of CCMV's net earnings accrued as a result of its failure to comply with the Act's requirements," Pet. App. A44 n.7, and that this litigation "suggests that a substantial amount of profits passed to the individual defendants as a result of their violations," *id.* at A40. Nevertheless, the district court initially rejected HUD's proposal that the individual petitioners incur continuing joint and several liability for the entire $8,648,048 amount, *id.* at A44, and it allowed petitioners to offer evidence showing that part of that amount was not passed through CCMV to them, *id.* at A44, A70. As the court of appeals observed, "HUD and the district court doubtless envisioned that a searching inquiry into the individual defendants' finances would follow to see how much of the ill-gotten gains had flowed through CCMV and into their pockets." *Id.* at A9. Petitioners nonetheless disregarded the district court's repeated instructions to submit evidence and refused to respond to HUD's discovery or to produce documents that might have led to a more exact calculation. *Ibid.* Because of their default, they have no basis for complaint against the district court's calculation of the disgorgement award.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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